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No. 89-1927

In The

Supreme Court of the United States

October Term, 1989

United States of America,

Petitioner

v.

First Federal Savings and Loan Association
of Temple, Texas,

Respondent

On Petition For A Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

Vester T. Hughes, Jr.
Counsel of Record
Cynthia M. Ohlenforst
Jay H. Hebert

Hughes & Luce
1717 Main Street, Suite 2800
Dallas, Texas 75201
(214) 939-5500

Counsel for Respondent

QUESTION PRESENTED

Whether a financial institution that realized and recognized a loss on its disposition of mortgage loans is precluded by Section 165 of the Internal Revenue Code from deducting that loss.

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent respectfully requests that this Court deny the petition for a writ of certiorari in this case. In the alternative, Respondent respectfully requests that, if the Court grants the petition, it limit the grant to the issue on which the courts of appeals disagree: whether a financial institution that realized and recognized a loss on its disposition of mortgage loans is precluded by Section 165[1] of the Internal Revenue Code from deducting that loss.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fifth Circuit (Pet. App. 1a-3a) is reported at 887 F.2d 593. The opinion of

[1] All Section references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended and in effect for the year at issue, unless otherwise noted.

the District Court for the Western District of Texas (Pet. App. 4a-45a) is reported at 694 F. Supp. 230.

STATEMENT OF JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was entered on November 2, 1989. A petition for rehearing was denied on January 19, 1990. (Pet. App. 46a-47a). On April 10, 1990, Justice White extended the time within which to file a petition for a writ of certiorari to and including May 18, 1990. On May 4, 1990, Justice White further extended that time to and including June 8, 1990. The petition for a writ of certiorari was filed on June 8, 1990. Counsel for First Federal Savings and Loan Association of Temple, Texas received a copy of the petition for a writ of certiorari on June 12, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

First Federal Savings and Loan Association of Temple, Texas ("Temple") is a mutual savings and loan association formerly regulated by the Federal Home Loan Bank Board ("FHLBB").[2] In 1980, Temple's mortgage loan portfolio was partially composed of fixed-rate, long-term, home-mortgage loans that had been issued in the late 1960s at interest rates significantly lower than those charged on more recent loans. As a result of the higher interest rates of the early 1980s, the fair market value of the older, low-interest mortgages fell far below their face amount. *First Fed. Sav. & Loan Ass'n v. United States*, 694 F. Supp. 230, 233-34 (W.D. Tex. 1988), *aff'd*, 887 F.2d 593 (5th Cir. 1989).

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[2] Pursuant to Rule 29.1 of the Supreme Court Rules, Temple states that it has no parent company and that its only subsidiary is wholly owned.

On December 31, 1980, Temple conveyed all its rights, title and interest in 360 low-interest rate mortgages to First Federal Savings and Loan Association of Waco, Texas ("Waco") at a discount from their face amount to reflect their decreased value. On the same day, Temple purchased 287 mortgages from Waco at a discount. These transactions were "reciprocal sales" pursuant to Memorandum R-49 of the FHLBB. Memorandum R-49 embodied a policy decision of the FHLBB to allow financial institutions to sell mortgage loans at a loss without reporting the loss for regulatory purposes, so long as the sale was part of a "reciprocal sale" in which the financial institution acquired mortgages that were "substantially identical" for regulatory purposes. This policy decision enabled a financial institution to sell low-interest rate mortgages at a loss without running the risk that the loss would prevent the financial institution from complying with the FHLBB's minimum reserve and liquidity requirements. *See id.* at 234-35. Memorandum R-49 further reflected the FHLBB's understanding (and the then-prevailing Internal Revenue Service view) of tax law — that reciprocal sales involving mortgages with different obligors and different collateral constituted recognition events for federal income tax purposes.

Temple reported on its 1980 federal income tax return a loss on the transaction of $3,715,132, the difference between the face amount and the value of the mortgages sold to Waco. On audit, the IRS claimed that Temple was not entitled to deduct its loss on the mortgages sold to Waco. Temple paid the resulting income tax deficiencies and filed this refund action in the United States District Court for the Western District of Texas. After a trial to the court, the district court held that Temple had incurred an "actual, economically real loss," *id.* at 249, and that Temple had "fully and completely disposed of" the mortgages it transferred to Waco, *id.* at 242. As a result, the district court held that Temple realized a loss

regardless of whether the mortgages Temple transferred were materially different from the ones Temple received. *Id.* at 247-48. The district court further held that a realized gain or loss must be recognized unless specifically excluded from recognition by statute, and that no non-recognition provision of the Code precluded the recognition of Temple's realized loss. *Id.* at 246-49. The district court specifically held that Section 165 does not preclude the deduction of Temple's recognized loss. *Id.* at 248-49.

The Court of Appeals for the Fifth Circuit affirmed the district court's judgment, but on different grounds; the Fifth Circuit concluded that an exchange of property gives rise to a realization event for federal income tax purposes only if the properties exchanged differ materially in kind or extent, but that the mortgages exchanged by Temple and Waco were materially different because the mortgages had different obligors and different collateral. *First Fed. Sav. & Loan Ass'n v. United States*, 887 F.2d 593, 594-95 (5th Cir. 1989). Thus, the Fifth Circuit agreed with the district court that Temple realized and recognized a loss for federal income tax purposes and that Section 165 does not preclude the deduction of that loss. *Id.* The panel that heard this case reached the same result in two other cases that were heard on the same day and involved reciprocal sale transactions under Memorandum R-49. *San Antonio Sav. Ass'n v. Commissioner*, 887 F.2d 577 (5th Cir. 1989) (which the court treated as the lead case); *Centennial Sav. Bank FSB v. United States*, 887 F.2d 595 (5th Cir. 1989).

SUMMARY OF ARGUMENT

The Government's Petition for Writ of Certiorari asks this Court to determine, as part of its analysis, whether a financial institution realizes a loss for federal income tax purposes on certain exchanges of mortgage loans. *There is no conflict*

among the circuits on this issue. Three courts of appeals have addressed the realization issue in the context of Memorandum R-49 reciprocal sales; all three agree that the financial institutions involved realized a loss on these transactions. Although the circuits disagree as to whether this loss is deductible under Section 165, the Section 165 issue (which was correctly decided by the Fifth Circuit in this case) does not present an important, continuing question of law. This Court should therefore exercise its discretion to deny the Government's petition. If the Court grants the petition, the Court should limit the grant to the Section 165 issue.

REASONS FOR NOT GRANTING THE WRIT

I. THE PETITION SHOULD BE DENIED BECAUSE ALL THREE COURTS OF APPEALS THAT HAVE CONSIDERED R-49 RECIPROCAL SALES HELD THAT TAXPAYERS REALIZED AND RECOGNIZED LOSSES ON THESE TRANSACTIONS.

The Government has based its Petition for Writ of Certiorari on its claim that there is "a square conflict in the circuits." (Pet. at 7). The Government's petition fails to point out, however, that all three courts of appeals that have considered R-49 reciprocal sales held that taxpayers realized and recognized losses as a result of reciprocal sale transactions.

According to the Fifth Circuit, "Temple *did realize the recognizable loss* it claimed on the R-49 transaction." *First Federal*, 887 F.2d at 595. (emphasis added).

The Sixth Circuit agreed: "We believe the loss in this case *was technically realized* in the sense that an earlier decline in value of the fixed-rate mortgage loans was fixed by an identifiable event — the 'reciprocal sales' transaction. Since there is no Code exception that applies, under § 1001(c) the *loss*

must be recognized." *Cottage Sav. Ass'n v. Commissioner*, 890 F.2d 848, 852 (6th Cir. 1989) (emphasis added).

The D. C. Circuit also agreed, stating that, "[i]n order for a loss resulting from an exchange of property to be recognized for tax purposes *it must be realized*," *Federal Nat'l Mortgage Ass'n v. Commissioner*, 896 F. 2d 580, 583 (D.C. Cir. 1990) (emphasis added), and "*FNMA is entitled to recognize the losses it incurred*, *id.* at 589 (emphasis added).

Thus, all three courts agree that the reciprocal sales transactions met the requirements for realization and recognition. (The D. C. Circuit's observation that the Fifth and Sixth Circuits reached contrary conclusions about whether the taxpayers realized losses, *id.* at 583, is therefore incorrect.) The Fifth and D.C. Circuits found that the mortgages transferred were materially different (because the mortgages had different obligors and different collateral), whereas the Sixth Circuit held, without reaching the question of whether the mortgages exchanged were materially different for tax purposes, that the reciprocal sales resulted in realization events. *Compare San Antonio*, 887 F.2d at 589 *and FNMA*, 896 F.2d at 584 *with Cottage*, 890 F.2d at 852 (loss was realized), 855 (the court's recitation that Cottage received "a substantially identical pool of mortgages" appears to be referring to the R-49 criteria, since the court's opinion contains no tax analysis of the differences among the mortgages).

II. IF THE PETITION IS GRANTED, THE COURT SHOULD LIMIT THE GRANT TO THE QUESTION ON WHICH THE COURTS OF APPEALS DISAGREE: WHETHER A FINANCIAL INSTITUTION THAT REALIZED AND RECOGNIZED A LOSS ON ITS DISPOSITION OF MORTGAGE LOANS IS PRECLUDED BY SECTION 165 FROM DEDUCTING THAT LOSS.

This Court has the discretion to limit the grant of a petition for a writ of certiorari to particular issues raised in the petition. *See, e.g., Sisson v. Ruby*, 110 S.Ct. 863 (1990); *Pacific Gas and Elec. Co. v. State Energy Resources Conservation and Dev. Comm'n*, 457 U.S. 1132 (1982). Because all three courts of appeals that have analyzed the federal income tax consequences of Memorandum R-49 reciprocal sales agree that taxpayers realized and recognized losses on these transactions, the Court should exercise its discretion to limit the grant of the Government's petition to the question on

which the courts were not unanimous — whether Section 165 precludes the deduction of the realized, recognized loss.[3]

III. NOTWITHSTANDING THE SPLIT BETWEEN THE COURTS OF APPEALS ON THE SECTION 165 ISSUE, THE PETITION SHOULD BE DENIED.

A. The Circumstances Prevailing at the Time of the Underlying Transactions Have Changed so that the Question Presented by this Case is not a Continuing Issue.

The existence of a conflict among the courts of appeals on the Section 165 issue does not mandate the grant of a petition for a writ of certiorari. *See* Sup. Ct. R. 10 (review on writ of certiorari is a matter of discretion); *see also Sokol Bros. Furniture Co. v. Commissioner*, 185 F.2d 222, 224 (5th Cir. 1950) (expressly taking a position that contradicts a Ninth Circuit holding on same issue), *cert. denied*, 340 U.S. 952 (1951). In the past this Court has been especially willing to

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[3] If this Court does not deny the Government's petition in this case, Temple respectfully requests that the Court grant Temple the opportunity to present its own case, instead of holding this case pending the outcome of related cases. Temple has already paid the taxes at issue and has a direct and compelling interest in the outcome of this case. (Unlike the taxpayers in *Centennial and San Antonio*, Temple is not in receivership and is not represented by the Resolution Trust Corporation.) Moreover, the issues will be better articulated if the litigants include a savings and loan association that was regulated by the FHLBB during the relevant time period. (The taxpayer in *FNMA*, by contrast, was not regulated by the FHLBB and was in a somewhat different situation from that of the savings and loan associations which engaged in R-49 transactions.) In an adversarial legal system that is based on the clear articulation of issues by parties in direct interest, the system and the litigants are best served by allowing the issues to be debated by those whose stake is real rather than theoretical and whose interests are truly adverse.

deny a petition for a writ of certiorari, despite a conflict among the circuits, when the question at issue is not of a continuing nature. *See generally* Stern, *Denial of Certiorari Despite a Conflict*, 66 Harv. L. Rev. 465, 470 (1953).

The Section 165 issue presented in this case is not of a continuing nature and does not merit this Court's review. The Government's expert witness testified at trial, on Petitioner's behalf, that R-49 transactions were unique to the 1980 time period, in part because financial institutions now have more sophisticated, convenient methods of dealing in the secondary market. (App., *infra*, at 1a). Temple's expert witness testified that in 1980 generally accepted accounting principles permitted financial institutions not to report losses on R-49 transactions, but that the current thinking of the accounting profession is that such losses should be reported. (App., *infra*, at 2a). It is therefore no longer possible for a financial institution to dispose of assets at a loss in an R-49 type transaction without reporting that loss on its books.

These changed circumstances mean that the R-49 transactions do not present a continuing issue. Thus, the question of whether a financial institution that engages in R-49 transactions is able to deduct its realized, recognized loss on the reciprocal sale transaction is not a continuing question of law worthy of the Court's time and attention.

B. The Court Below Correctly Held That Section 165 Does Not Preclude Temple's Deduction of its Realized, Recognized Loss.

In its *Centennial* petition for a writ of certiorari (which the Government uses as its lead petition on the R-49 cases), the Government devotes only a footnote (Pet. in *Centennial* at 15 n.12) and a few scattered references to Section 165; the scant attention devoted to this issue reflects the weakness of the

Government's reliance on Section 165.[4] Section 165(a) provides that a taxpayer is allowed to deduct any losses that it sustains during a taxable year for which the taxpayer does not receive offsetting compensation from insurance or some other source. The district court found that Temple "indeed suffered a real economic reduction in the value" of the mortgages at issue, *First Federal*, 694 F. Supp. at 248, and parted with all of its rights, title and interest in the mortgages it sold to Waco, *id.* at 242. The Fifth Circuit specifically confirmed the district court's finding that "IRC § 165 does not preclude Temple from realizing its loss." *First Federal*, 887 F.2d at 595; *accord San Antonio*, 887 F.2d at 592-93; *see also FNMA*, 896 F.2d at 584-85.

The Sixth Circuit's conclusion to the contrary overturned a unanimous Tax Court holding that the losses are deductible under Section 165. *Cottage*, 890 F.2d at 853-55, *rev'g*, 90 T.C. 372, 401 (1988)(reviewed). The Sixth Circuit's conclusion that Cottage did not sustain a loss on its R-49 reciprocal sales is not only inconsistent with the Fifth and D.C. Circuits and a unanimous Tax Court, but also appears inconsistent with its own conclusion that "[s]ince there is no Code exception that applies, under § 1001(c) the loss must be recognized." *Cottage*, 890 F.2d at 852. Similarly, the court's theory that Section 165 will not permit deducting a loss when "the taxpayer's economic position was not changed for the worse," *id.* at 854, is at odds with the court's acknowledging "an earlier decline in value" of the taxpayer's mortgage loans, *id.* at 852. Contrary to the court's reasoning, Section 165 does not preclude deducting a loss merely because a taxpayer does not worsen its economic position by the exchange itself. If that were the

[4] By contrast, the Government devotes six full pages of its petition in *Centennial* to the realization issue. *Id.* at 14-20. However, as noted at pages 5-6 of this Brief in Opposition, there is *no conflict among the circuits on the realization issue.*

case, an exchange for fair market value could *never* result in a deductible loss, because a taxpayer who receives fair market value in exchange for his asset is in exactly the same economic position after the exchange as before.

The Government cites the truism that "[s]ubstance and not mere form shall govern in determining a deductible loss." Pet. in *Centennial* at 15 n.12 (citing Treas. Reg. § 1.165(1)(b)). However, Temple's disposition of mortgages was a complete disposition of those mortgages *in substance and in form*. In the classic *Gregory v. Helvering*, 293 U.S. 465 (1935), on which both the Sixth Circuit and the Government rely (*Cottage*, 890 F.2d at 853; Pet. in *Centennial* at 14), this Court found a transfer of assets by one wholly-owned corporation to another wholly-owned corporation (that immediately liquidated and distributed the assets to its sole shareholder) to be "an elaborate and devious form of conveyance masquerading as a corporate reorganization and nothing else." *Id.* at 470. In short, the Court found there were papers establishing a corporate reorganization, but no corporate reorganization. If, following the reciprocal sales at issue in this case, Temple had retained its own mortgages, its "disposition" of the mortgages would have been mere form

without substance. Temple, however, did not retain its own mortgages.[5]

Temple's reciprocal sales transaction had economic substance. Temple parted with all of its rights, title and interest in the mortgages it sold to Waco. The mortgages it purchased from Waco had different obligors and different collateral. Different obligors and different collateral means different locations (not only by neighborhood, but also by city), different financial circumstances of the borrowers, and different payment histories for the mortgages (both before and after the reciprocal sales). These differences are not only genuine, they are the essence of loan obligations.

Unlike the taxpayers in the cases on which the Sixth Circuit relied in *Cottage*, Temple did not simply reacquire the same asset that it "transferred." *See Shoenberg v. Commissioner*, 77 F.2d 446 (8th Cir.), *cert. denied*, 296 U.S. 586 (1935) (taxpayer sold, and repurchased through a controlled investment company, stock in the identical corporation); *Horne v. Commissioner*, 5 T.C. 250 (1945) (taxpayer sold and pur-

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[5] In addition, Temple's transaction "was not purposeless apart from its tax motivations." *First Federal*, 694 F. Supp. at 248. The district court below specifically found that:

> the transaction also served the legitimate purpose of allowing Temple to dispose of assets declining in value and reinvest in new assets (albeit the same kind) at a lower basis. This serves the purpose of allowing a business to cut its losses and start afresh with new assets and with more potential to show a profit.

Id. at 248-49. Moreover, the record shows that the Temple executives felt that the transfer would be good for Temple in that the transfer would geographically disperse its investments, diversify its loan portfolio, restructure its assets to obtain increased cash flow and shorter terms, and allow Temple to gain experience in selling and purchasing investments on the secondary market.

chased a seat on the identical commodities exchange). Furthermore, as the D. C. Circuit noted, the reciprocal sales transactions did not "*generate* losses that would otherwise not exist. . . . [They] merely provided a means to recognize the losses without simultaneously threatening the existence of the FHLBB-regulated lenders." *FNMA*, 896 F.2d at 584 (emphasis in original). Section 165 clearly does not preclude the deduction of these very real losses.

IV. THE GOVERNMENT'S STATEMENT OF THE QUESTION IN ITS PETITION IS MISLEADING.

In its petition, the Government states the Question Presented as: "Whether a financial institution realizes a deductible loss for income tax purposes when it exchanges a group of mortgage loans for a substantially identical group of mortgage loans held by another financial institution."

As noted above, the Government's statement of the question implies (inaccurately) that the issue of realization is a subject of debate among the circuits. The Government's question is also misleading because it assumes (incorrectly) that the loans are "substantially identical" for tax purposes.[6] First, the "substantially identical" standard is a regulatory standard for Memorandum R-49 purposes; it is not determinative of the federal income tax consequences of the transactions at issue. Second, the Fifth Circuit specifically found that the exchanged mortgages were materially different. *First Federal*, 887 F.2d at 595; *accord* FNMA, 896 F.2d at 584. Indeed, mortgages with different obligors and different collateral are materially different as a matter of law. Just as shares of Mobil stock are different from shares of Exxon stock

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[6] If the Government's reference, in its Question Presented, to "a group" of mortgage loans is intended to imply that the mortgages must be considered as a group for tax purposes, the Question is also misleading in that respect.

and shares of one mutual fund are different from shares of another, even though the marketplace might assign the same value to them, a debt of one individual secured by collateral *A* is materially different from a debt of another individual secured by collateral *B*. *See, e.g.*, *Hanlin v. Commissioner*, 108 F.2d 429, 430-31 (3rd Cir. 1939) (bonds of the St. Louis and Wichita Federal Land Banks held not substantially identical to bonds of the Louisville Federal Land Bank for purposes of the wash sales provision because the bonds were secured by different collateral); Rev. Rul. 59-44, 1959-1 C.B. 205 (bonds ruled not substantially identical for federal income tax purposes because primary obligors were different). Prior to the R-49 reciprocal sales, the Internal Revenue Service had specifically ruled that a savings and loan association realized a loss on an exchange of a pool of mortgages for another pool of mortgages having the same aggregate fair market value and face amount. Rev. Rul. 73-558, 1973-2 C.B. 298.

Consistent with the Government's early rulings, and contrary to its argument in this case that assets must be economically dissimilar to be materially different (*see* Pet. in *Centennial* at 18 n.14), the D. C. Circuit correctly held that "[t]he differences in the underlying properties and obligors foreclose any argument that the exchanged mortgages were identical." *FNMA*, 896 F.2d at 584.

Nevertheless, the Government argues in its petition that because the mortgages were "substantially identical" for regulatory purposes, the mortgages may not be "materially different" for federal income tax purposes. (Pet. at 5). Among other shortcomings, this argument fails to take into account the different purposes of the two regulatory standards. The fact that one government agency (FHLBB) considered mortgages "substantially identical" for its regulatory purposes does not mean that another government agency (IRS) could

not consider the same mortgages to be "materially different" for its purposes. For example, one government agency might decide that a Jaguar automobile and an Oldsmobile 98 are substantially identical. The cars are, of course, indisputably different — the image they project, their cost, their performance and so on — but to a government agency charged with the task of classifying motor vehicles for the purposes of assessing highway tax, the two motor vehicles might well be "substantially identical" as far as their respective wear on the highway. However, an insurance company assessing the risks of selling liability insurance might decide that the vehicles are "materially different." A State Board of Insurance inquiry as to the validity of the proposed insurance rates surely would not be bound by the highway taxing authority's determination that the vehicles are "substantially identical" for its purposes.

In promulgating the "substantially identical" standard, the FHLBB focused not on the individual assets that Temple (or any other financial institution) owned, but on the requirement that each institution's balance sheet remain in satisfac-

tory condition. The "material difference" standard, on the other hand (to the extent that such a standard even exists),[7] focuses on a taxpayer's rights to a specific property and

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[7] As Judge Smith pointed out in *First Federal*, 694 F.Supp. at 246-48, Section 1001(c) requires recognition of gain or loss regardless of whether properties exchanged differ materially. *Accord Cottage Sav. Ass'n v. Commissioner*, 90 T.C. 372, 403-04 (1988) (Cohen, J., concurring), *aff'd on this issue*, 890 F.2d 848 (6th Cir. 1989). Despite the Fifth Circuit's erroneous conclusion to the contrary, *San Antonio*, 887 F.2d at 586, the court below reached the correct result in Temple's case because it correctly concluded that the mortgages Temple transferred were materially different from those it received.

Because Temple's loss is realized regardless of whether Section 1001 embodies a "materially different" requirement, Temple will not reiterate at length the authorities in support of the conclusion that there is no such requirement. It is noteworthy, however, that when Congress enacted Section 203 of the Revenue Act of 1924 (ch. 234, § 203, 43 Stat. 253, 256 (1924)), the predecessor to Section 1001(c), Congress intentionally adopted a blanket rule that all gain or loss on an exchange is recognized in the absence of an applicable statutory exception. *See, e.g.*, Sections 1031 (nonrecognition for certain like-kind exchanges); 1091 (for wash sales). In the House and Senate Reports to the 1924 Act, Congress explicitly stated its intention to enact a broad-sweeping recognition requirement:

> It appears best to provide generally that *all gain or loss is recognized from all exchanges* and then except specifically and in definite terms those cases of exchange in which it is not desired to tax the gain or allow the loss. This results in definiteness and accuracy and enables a taxpayer to determine prior to the consummation of a given transaction the tax liability that will result therefrom.

H.R. Rep. No. 179, 68th Cong., 1st Sess. 13 (1924); S. Rep. No. 398, 68th Cong., 1st Sess. 14 (1924). Because gains and losses that are recognized must necessarily be realized, Congress's mandate in Section 203 of the 1924 Act that gain or loss be recognized on all exchanges necessarily acknowledges that gain or loss is realized on all exchanges.

whether an exchange of those rights for other rights is a realization event. Simply put, the FHLBB was worried about the long-term survival of the forest (the overall health of the financial institution), and the Service's proper concern is the short-term effect of disposing of a few of the trees (the tax effect of the disposition of mortgages).

CONCLUSION

For the reasons given above, the petition for a writ of certiorari should be denied or, in the alternative, grant of such petition should be limited to the Section 165 question on which the courts of appeals disagree.

Respectfully submitted,

VESTER T. HUGHES, JR.
Counsel of Record
CYNTHIA M. OHLENFORST
JAY H. HEBERT

HUGHES & LUCE
1717 Main Street, Suite 2800
Dallas, Texas 75201
(214) 939-5500

Counsel for Respondent

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APPENDIX

The following excerpts are from the trial transcript (Vol. 6 of the record of *First Federal Savings & Loan Assoc. of Temple v. United States,* Civil Action No. W-86-CA-117) (decision reported at 694 F.Supp 230, *aff'd,* 887 F.2d 593).

1. **Testimony (direct examination) of Donald A. Zellmer, expert witness for the Government, Trial Transcript at 352-353.**

Q Were the Memorandum R-49 reciprocal mortgage sale transactions a transaction unique to the period right around 1980?

A Yes.

Q Okay. Why — why is it limited to that time period?

A Well, as I indicated, the — the — the threshold, the entry level of — into the secondary market was reduced substantially. Associations didn't have another way to pool mortgage loans and sell them, except under the criteria for 49, back in 1980, unless they were very large institutions, and, of course, we didn't have many of those. Also, I don't think you would — would see reciprocal loan sales today, because there are more sophisticated and much more convenient ways of accomplishing the same end result, given the development of the — not only the secondary market, but the whole realm of financial instruments. And then finally, the — the tax benefits aren't as sought after as they were then, because most asso — many associations are now in a net operating loss situation, and it wouldn't derive the — the cash from the tax benefits and, consequently, wouldn't have it for reinvestment.

2. Testimony (direct examination) of Robert Creager, expert witness for Temple, Trial Transcript at 191-192.

Q Now, looking at Generally Accepted Accounting Principles as they existed in 1980, did Generally Accepted Accounting Principles require that a loss on a transaction such as the one that occurred between First Federal of Waco and First Federal of Temple on December 31, 1980 be recognized?

A That was a very grey area in 1980. The general accounting principle is, that you recognize a loss or a gain on the disposition of an asset. However, the Federal Home Loan Bank Board, in its R Memorandum, set forth ten criteria for which they did not believe a loss need be recognized. Now, it's true, in 1980, that most accountants, or that I'm aware of, considered that this type of transaction, in which the loss would not be recognized, would also be appropriate for Generally Accepted Accounting Principles.

Q Well, why, in 1988, would GAAP require reporting of a loss, if it wasn't — if it was not required in 1980?

A Well, I think we've gotten smarter. Accounting, like law, evolves over time. And the current thinking of the profession is, that the recognition of the loss more accurately reflects the income that should be reported of an institution that engages in such a transaction.